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ADOPTION OF THE REPORT OF THE COMMISSION ON ITS TWENTIETH SESSION

Rapporteur: ...

Draft report

Chapter ...

COUNTRY AND REGIONAL EXPERIENCES IN ATTRACTING FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT

Country and regional experiences in attracting foreign direct investment for development

The Commission considered item 6 of its agenda at the .. and .. meetings, on 4 and 5 May 1994. It had before it the following documents:

(a) Report of the Secretary-General on foreign direct investment in Africa (E/C.10/1994/5);

(b) Report of the Secretary-General on foreign direct investment to the least developed countries and other developing countries outside Africa (E/C.10/1994/6);

(c) Report of the Secretary-General on the exchange of information on foreign direct investment (E/C.10/1994/7).

In introducing the item, the Assistant Director, Research and Policy Analysis Branch of the Division on Transnational Corporations and Investment stated that the recent spectacular growth of foreign direct investment flows

to developing countries has been unevenly distributed among developing-country groups and regions. The group of the least developed countries did not participate in this growth. Flows to Africa - which includes the largest concentration of least developed countries - did not increase either; as a result, the share of Africa in developing-country inflows to developing countries halved to 6 per cent between the second half of the 1980s and the early 1990s. He noted accordingly, that most of the growth of FDI inflows to developing countries has been concentrated in East and South-East Asia, as well as Latin America and the Caribbean. While turning to Africa, he noted that the flows to this continent remain small despite the widespread liberalization of FDI policies undertaken by most of the African Governments during the 1980s, often as part of structural adjustment programmes. The attractiveness of Africa as a location for FDI continues to be constrained by the small size of most markets, weak private sectors, poor physical infrastructure, an uneven skill level and the heavy reliance on primary exports. He noted, however, that it would be wrong to generalize from the negative situations in some countries to the continent as a whole, because a number of countries in Africa - in addition to oil-exporting countries - are clearly more successful in attracting FDI than others, especially, if FDI inflows are measured in relative terms, e.g., as a per cent of GDP. The continuing reform efforts in many African countries should help improve their economic performance and thus increase the group of success countries.

Moving to the more successful regions as regards FDI, the Assistant Director of the Research and Policy Analysis Branch said that South, East and South-East Asia has been experiencing the fastest economic growth in the world, and has continued to be the largest host developing-country region to FDI flows, accounting for 57 per cent of the developing country total in 1992. China, in particular, has become the most dynamic and largest host country not only in this region but also in the developing world. Across the region, expanding markets are likely to continue to attract FDI. At the same time, shifts in cost advantages lead to the transfer of labour-intensive type of FDI from middle-income countries to low-income countries, while the former countries move towards receiving higher quality FDI and, particularly, FDI in the services sector. Domestic investors from these countries are also partaking in this process, thus reinforcing the emergence of these countries, and notably of the Republic of Korea and Taiwan Province of China, as major home countries for the region. Latin America and the Caribbean, as mentioned the Assistant Director,

have also benefitted from increased investment flows, thus marking a reversal of a trend. A considerable amount of this investment has been attracted to the primary and services sectors, sectors in which privatization programmes - a magnet for FDI in this region - predominated. While so-called "subsidized" FDI - that is, FDI undertaken through the participation in the privatization programmes and debt-equity conversions - is still important for the region, some countries have succeeded in attracting growing amounts of conventional FDI. Future inflows of FDI to this region will be facilitated by continued opening policies, including progress towards regional integration with other developing and developed countries, increased export orientation and the return of the countries of the region to international capital markets.

The speaker stressed that the broad-based trend towards a more open FDI framework has become an important feature across the developing world over the past decade. Given this overwhelming trend, the third report submitted to the Commission on this agenda item analysed the characteristics of the liberalization process and examined how far this process has gone. Noting that the process liberalization involves not only the reduction of market distortions due to restrictions and special incentives for FDI, but also the adoption of positive standards of treatment and protection for foreign investors, and the strengthening of controls and prudential supervision to ensure proper functioning of the market, he noted that on all these aspects FDI regimes around the world have changed in the direction of liberalization during the past decade. As important as these changes are for attracting FDI flows, however, they are only a part of what is necessary to create a favourable investment climate. An increasingly important aspect is a well-functioning legal framework for business operations in general, including well-functioning institutional and administrative infrastructure.

In concluding, the Assistant Director noted that while the process of liberalization is leading to a certain convergence of the characteristics of FDI regimes, there still exist numerous and important differences. At the same time, the integration of production across borders suggests that a number of national policies relating to the production process acquire international dimensions. This raises new challenges for policy-makers in all countries. Exchanges of

information among countries about their experiences with FDI and their policy frameworks could therefore be particularly useful.

Delegations from developed and developing countries as well as expert advisors agreed that, while there has been progress as regards foreign investment flows to developing countries as a group, some groups of countries, and especially the least developed countries and most of the African countries have not benefitted from the increased FDI flows to developing countries and have been marginalized in world FDI, in addition to world trade. Many delegations and experts shared the assessment contained in the reports before the Commission that, while prospects for foreign direct investment flows to Asia and Latin America are good, especially for the former, those to Africa are not, especially in the short run, despite the clear labour-cost advantage in manufacturing that many African countries now enjoy vis-à-vis other regions. In the long run the potential of Africa to receive foreign direct investment is substantial, provided, however, that structural problems (including, inter alia, investment in physical and human infrastructure) will be addressed by Governments, policy reforms carried out in a consistent manner and political and economic stability achieved. In case of the least developed countries meeting a number of these objectives - e.g. improvements in capital intensive infrastructure - will require significant inflows of the official development assistance.

Many delegations agreed with the explanation of the weak foreign direct investment performance in Africa contained in the report on foreign direct investment in Africa. Some delegations and one expert advisor asserted that there has been no evidence that structural adjustment programmes helped attract significant amounts of foreign direct investment to African countries. Some other delegations contended this view, stating, in turn, that such cases were rather an exception than the rule.

A number of speakers agreed that one of the key tasks of the Governments in Africa which undertook efforts to improve the investment climate in their countries is to change the image of their countries based on the image of all Africa emerging from the media as inhospitable location to foreign investors.

Several speakers shared with the Commission their regions' or countries' experiences in the area of attracting foreign direct investment and its role in

the development. One delegation emphasized that Asia's good economic performance has resulted from the appropriate mixture of market measures and correct government intervention and that a skilful use of foreign direct investment played a great role in this performance and suggested that a study of this experience be prepared for the next session of the Commission. An expert advisor from a developing country presented at length the positive response of TNCs to the opening of his country with a massive inflow of foreign direct investment and a number of positive influences, FDI exerted on this country in the areas of ownership structure, new forms of organizing business, management techniques, upgrading of local products and technology, creation of jobs and changing the local mentality to that more open to an outside world. While agreeing with this picture a delegate from the same country emphasized that in the case of his country FDI is a two-way street bringing benefits not only to his country but also to TNCs. In addition, the country has still a lot to do to attract capital from major home countries, as most of the recent investment originates from the nationals of the country living overseas.

A delegation from a developed country stressed that the country with such a success was a low-income country and that therefore its experience should be studied by other developing countries which have experienced difficulties with attracting significant amounts of FDI. It added that countries at a low level of development typically cannot count on large FDI inflows and that therefore it is normal that the least developed countries rely to the greater extent on the inflows of the official development assistance. Another delegation noted, however, that the size of this assistance is not sufficient, and that therefore supplementing it with the inflows of FDI was very important.

Searching for an answer to the question why FDI liberalization measures in a number of countries failed to attract FDI, a delegation from a large host developing country stated that its country found itself in a similar situation in the second half of the 1980s (actually FDI inflows even declined after liberalization), and that the underlying causes included the lack of financial stability of the country: perhaps lack of stability in various areas is a major cause of a weak response to the African liberalization. Another cause is most

likely a still unresolved problem of external indebtedness still persistent in many African countries.

A delegation from a developed country disagreed with the assessment in the report on Africa that all countries had liberalized their FDI policies in all sectors. In addition, many African countries are still lagging in the area of macroeconomic policy. In this context, he questioned the presentation of one of the large countries as a role model of FDI policies.

Experience sharing was not limited to host country's policies: one delegate drew the Commission's attention to the positive role that home country policies can play in encouraging investment flows to developing countries, citing his country as an example. He said that promotion of FDI is embedded in a broader framework of the support to the development process with the participation of private enterprises which are entrusted to take the initiative to establish joint ventures in developing countries.

One delegation expressed dissatisfaction with the weak coverage of the CEE region in the reports before the Commission. The Assistant Director responded immediately that an entire section is planned on this region in the World Investment Report 1994. A number of delegations from the region informed the Commission about their experiences with FDI. One delegation from a Central European country stated that foreign capital enters the region very carefully and provided the Commission with the results of the study on foreign investors' perception of the risks in the Central part of the region. The study showed a differentiated perception not always in line with a popular view of the progress in transition towards market economy on the one hand and the rise in most of these countries' attractiveness to foreign investors on the other hand.

Considerable discussion took place on further actions to be taken at the national, regional and multilateral levels to enhance the role of foreign direct investment and transnational corporations in economic development. The discussion focused on how to do so in the case of Africa. A delegation from a developed country and another delegation from a developing country suggested that efforts aimed at the improvement of the investment climate in Africa should be better coordinated in order to achieve concrete results. Many delegations including one speaking on behalf of a large group of countries strongly supported

the idea of a high-level symposium on FDI in Africa organized by the UNCTAD secretariat and called on countries in a position to do so to provide funding for this effort.

A number of suggestions were made to prepare specific studies aimed at helping attract FDI to developing countries or to exchange experience including a study on the role of FDI in the economic success of Asian countries and an analysis of the investment potential in each of the LDCs to inform TNCs about investment opportunities of these countries.

One delegation spoke about the importance of bilateral investment treaties as instruments to promote the flow of FDI between developed and developing countries. These instruments should also be taken into account when analysing governmental efforts to improve the investment climate and encourage FDI towards developing countries.

In sum, the importance of liberalizing FDI regimes and adopting facilitating measures for attracting foreign investors was generally recognized, but it was also noted that, in order to achieve maximum results, countries needed to focus on creating stable macro and microeconomic conditions. As a number of delegations explained their recent changes in their FDI regimes and their experiences in dealing with foreign investors it was noted that these exchanges indeed provide useful examples for other countries facing similar conditions and problems. Thus, a number of delegations suggested that the practice of exchanging experiences among Governments on FDI policies was very useful and should be encouraged. They observed that the Commission on Transnational Corporations, being the main forum within the United Nations on FDI matters, was the most appropriate body to carry on these exchanges which, however, could benefit for more structured and regular exchanges. Such exchanges, for example, could be facilitated and supported by the preparation of country studies involving the Secretariat, governmental experts and independent experts as the private sector and other interested parties. An alternative format for the exchanges of experiences could be to focus on specific issues each year, such as, for example, tax incentives, authorization procedures and settlement of disputes mechanisms.

In his concluding remarks, the Assistant Director summarized the main issues discussed and responded to specific questions raised by the delegations. He said that the focus on Africa during the discussion was important, given that Africa (including its LDCs) clearly lags behind other groups of developing countries as regards the growth of FDI inflows. While he did not dispute the importance of creating the appropriate image of individual countries vis à vis foreign investors, he noted, however, that in many cases it is the issue of unfavourable basic determinants of FDI which cannot be corrected easily in a short period of time. Nevertheless, all efforts should be made, and he welcomed in that context the support given to the investment symposium for Africa, to change this situation as soon as possible. He referred also to the ongoing work of the Secretariat on bilateral investment treaties and called on delegations to continue to provide the Secretariat with information on new treaties.

Action taken by the Commission

The Commission took note of the reports of the Secretary-General and requested the Secretary-General to continue its programme of work in this area, including especially country and regional experiences in attracting foreign direct investment for development as well as comparative studies on trends in policy frameworks around the world and their impact on FDI flows.

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